Item 13

6th March 2019

Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Jacqueline Gillies Ext: 75186

Investment Advisory Panel – Quarterly Report

Purpose of Report:

To provide the committee with a summary of the Investment Advisory Panel meeting held on Thursday 14th February 2019.

Recommendation:

The Committee is asked to **NOTE** the contents of this report.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐

consulted: Yes ☐ No ☐

1 Background

As a key element of its governance arrangements, the Strathclyde Pension Fund (SPF) maintains an Investment Advisory Panel (IAP). The role of the IAP, together with details of membership and meeting arrangements, is summarised in **Schedule 1**.

2 IAP Meeting – Thursday 14th November 2019

Present: Professor Geoffrey Wood, Eric Lambert, Iain Beattie, David Walker (Hymans Robertson), Chris Arcari (Hymans Robertson, part meeting only), Richard McIndoe, Jacqueline Gillies, Richard Keery, Ian Jamison (part meeting only), Lorraine Sweeney (part meeting only), Veronica Antonucci.

Agenda: Strategy Development Session

1) Minutes from last meeting and any matters arising
2) Investment Strategy and Structure
3) Monitoring
4) Allocation
5) Governance
6) Manager Reviews
7) AOCB

2.1 Minutes from Last Meeting & any Matters Arising

The minutes of the previous meeting were agreed to be an accurate record.

3 Investment Strategy and Structure

3.1 No. 3 Fund

A review of the No. 3 Fund is a development priority in SPF's 2018/19 business plan. At its meeting in December 2018, the Committee approved in principle a proposal First Group to merge all the assets and liabilities of the Strathclyde No. 3 Fund into the Aberdeen City Council Transport Fund, which is administered by the North East of Scotland Pension Fund (NESPF).

Officers updated the Panel on progress of the proposal. A plenary meeting had been held in January 2019 between from First Group (the sole employer in the No. 3 Fund), First Group's consultant (Hymans Robertson), SPF, and NESPF. A ministerial directive is required before the merger can take place and a draft application for this has been prepared and reviewed by all parties. The effective merger date is dependent on the progress of this application but it is proposed that it is followed by a transition period to 31st March 2020 to allow for the orderly transfer of member data and investment assets.

3.2 Private Debt Tender

At its meeting in February 2018, the SPF Committee agreed that a search and selection exercise should be initiated to identify suitable managers and/or funds for new investment allocations to private corporate debt and private real estate debt. Tender responses were received on 16th January 2019 and these had been evaluated by Hymans Robertson.

The Panel reviewed the tender analysis reports prepared for the mandates by Hymans Robertson.

The Panel considered a paper presenting options for allocations to different private debt mandates and managers. The Fund is in the process of implementing the strategic allocation ‘Alt 2’, and within ‘Alt 2’ the total private debt allocation is 4.5%. The Fund already has commitments to private corporate debt through funds managed by Alcentra and Barings. In light of existing commitments and the relative risk profiles of private corporate debt and private real estate debt, the Panel agreed that overall allocations of

- 3.5% of total Fund to private corporate debt; and
- 1.0% of total Fund to private real estate debt

would be appropriate.

The final allocation between managers within these two mandate types is dependent on the outcome of the final stage of the tender process, a presentation from each candidate who met minimum criteria to the Committee Sounding Board. These presentations had yet to take place at the time of the Panel meeting.

Analysis of the tenders received and recommendations for appointment would be the subject of a separate report to Committee.

4 Monitoring

4.1 Quarterly Investment Performance Review (Main Fund)

The Panel reviewed the Northern Trust investment performance monitoring report. Global equity market volatility meant that the Fund’s return for Q4 2018 was negative (**-5.4%**), but ahead of benchmark (**-5.8%**) due largely to the outperformance of some long term enhanced yield mandates. Absolute performance for the one year period is negative but in relative terms, the Fund outperformed its benchmark. Absolute and relative performance have been positive over three and five year periods.

4.2 Quarterly Investment Performance Review (No. 3 Fund)

The Panel reviewed the Northern Trust investment performance monitoring report for the No. 3 Fund and a summary monitoring the Fund’s position relative to its de-risking strategy. The Fund’s return for Q4 2018 was above the benchmark return (+**0.6% vs +0.4%**). The No.3 Fund has underperformed over one year and five years, but is ahead of benchmark over three years and since inception.

4.3 Manager Ratings

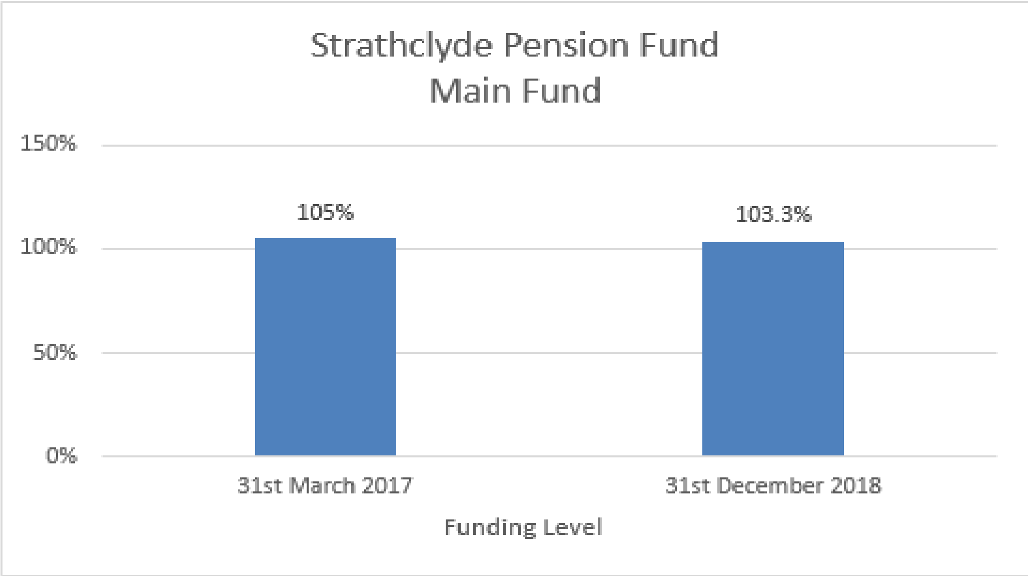
Current officer assessments of the Fund’s investment managers had been circulated, together with Hymans Robertson’s manager update. Four of the Fund’s managers are rated amber, with twelve rated green.

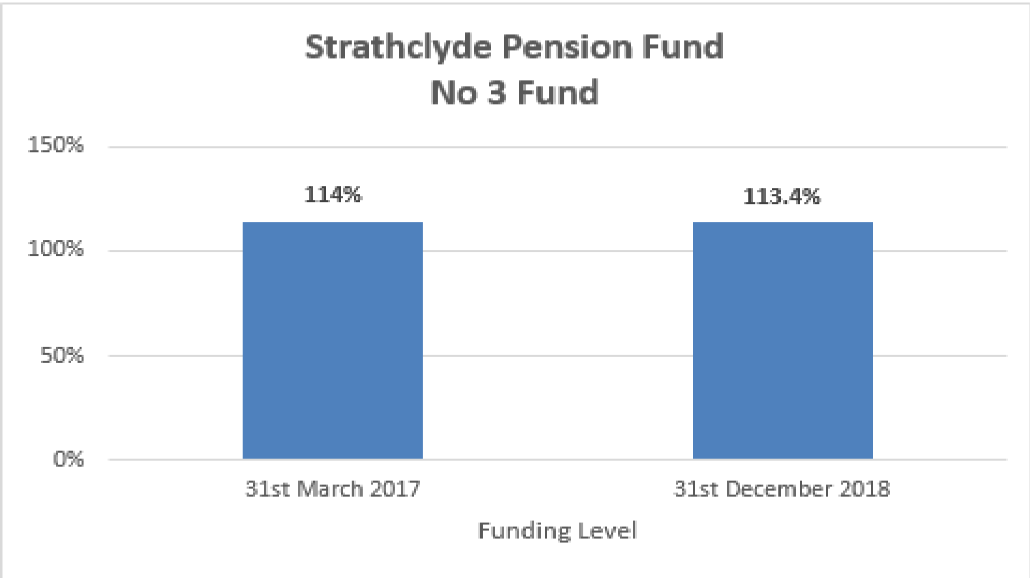
4.4 Direct Investment Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Investment Portfolio (DIP). The portfolio and most of its investments were progressing well. On a Red, Amber, Green (RAG) analysis, thirty three investments were rated green, four amber, and none red.

4.5 Estimated Funding Levels

Hymans Robertson provided the following estimates of the funding levels as at 31st December 2018 for the main Fund and No. 3 Fund. Funding levels for both had decreased since the 31st March 2017 actuarial valuation.





4.6 Brexit

The Panel discussed the potential impacts on the Fund of the UK's withdrawal from the European Union (EU), currently scheduled for 29th March 2019.

The outline draft withdrawal agreement sheds little light on the impact of Brexit on financial services compared to what the industry knew following the result of the referendum. However, all of the Fund's investment managers have given appropriate consideration to the possible implications of Brexit. In particular they have reviewed their portfolios and the impact on investment holdings under the various potential 'Brexit' scenarios. A number of UK domiciled managers have also sought agreement from the Fund to amend contractual arrangements so that they can continue to market their funds to clients in the remaining 27 EU countries following the UK withdrawal. Amendments requested to date will not impact on the management and servicing of the Fund's portfolios, and so they have been agreed by, and implemented at no cost to, SPF.

The financial and economic impacts of Brexit will depend to a large extent on the manner in which the UK leaves the EU. Short-term volatility in markets is anticipated, while the consequences on the value of Sterling is likely to be the most significant determinant of the scale of any short term impact on the Fund's investment portfolios. The Fund's investment focus is global and long-term, however, and there is no indication that Brexit will prevent the Fund from fulfilling its long term investment objectives.

5 Allocation

5.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes - private equity, global real estate, the Direct Investment Portfolio, and private debt commitments. Totals as at 31st December 2018 were as follows.

	2018 Estimate (£m)	**2018 Actual YTD (£m)**	**2019 Estimate (£m)**
Distributions	465	475	564
Calls	(730)	(695)	(616)
Net	**(265)**	**(220)**	**(52)**

The net cash flows for 2018 were **(£220m)**, **£45m less than had been estimated**. The projected net cash flows to private markets programmes in 2019 is **(£52m)**. The Fund's private debt and Direct Investment portfolios are still building their investment exposure and drawdowns to these investments are expected to exceed distributions from them. The Pantheon private equity and the Partners Group private equity and real estate programmes are mature portfolios and distributions will largely cover the anticipated drawdowns to more recent fund commitments.

The Fund's cash balance at 31st December 2018 was £984m. This had reduced from £1,452m at end September 2018. During Quarter 4 2018, £300m had been drawn from Legal and General cash funds and transferred to fund the first tranche of investment into JP Morgan's International Infrastructure Fund, Cash balances were further reduced as money was transferred to fund a property purchase by DTZ, benefits cash flow and drawdowns to private market programmes.

5.2 Re-balancing strategy

The Panel reviewed a re-balancing report as at 31st December 2018.

There were a number of breaches of ranges but the Panel agreed that no additional action is required as these will be resolved as the implementation phase of the review of investment strategy progresses.

The Panel noted that the Fund maintained an emerging markets futures position with Legal and General. The Panel agreed that the Fund should maintain this exposure to emerging markets, but that Officers should review alternative implementation options.

6 Governance

6.1 Strathclyde Pension Fund Committee

The Panel noted the draft agenda for the next committee meeting on Wednesday

6th March 2019.

7 Manager Reviews

The following investment managers attended the Investment Advisory Panel.

- JP Morgan
- DTZ
- PIMCO
- Alcentra

Performance of each of the managers was reviewed.

JP Morgan

The JP Morgan global small-cap portfolio is currently valued at £686.2m, or 3.3% of total Fund, versus a target weight of 3.0%. JP Morgan provided an update on the performance of the portfolio.

DTZ

The DTZ UK property portfolio is currently valued at £2,017m, or 10.1% of total Fund, versus a target weight of 10.0%. DTZ provided an update on the Fund's existing UK property portfolio including the most recent sale in Stevenage and purchase in Manchester completed in Q4 2018, together with an outline of investment objectives for the forthcoming year,

PIMCO

The PIMCO absolute return portfolio is currently valued at £1,044m, or 5.0% of total Fund, versus a target weight of 5.0%. PIMCO provided an update on the Fund's existing investment in PARS III, which had underperformed since the switch from PARS II. 2018 performance was particularly disappointing.

Alcentra

The Alcentra portfolio is currently valued at £163m, or 0.8% of total Fund, versus a target weight of 0.8%. Alcentra provided an update to the Panel on the Fund's existing investment in Clareant European Direct Lending Fund II and on its more recent commitment of £250m to Alcentra Clareant European Direct Lending Fund III.

8 AOCB

8.1 Review of the Structure of the Scottish Local Government Pension Scheme

Officers of the Fund updated the Panel on the progress of the consultation on the structure of the Local Government Pension Scheme (LGPS) in Scotland. The deadline for responses to the consultation was in December 2019. There had been 49 responses with a broad spread of views. These had now been published on the Scheme Advisory Board website. The Pensions Institute is currently collating the submissions and carrying out additional analysis, and is expected to report on them to the Scheme Advisory Board in April. The Scheme Advisory Board will then make recommendations to Scottish Ministers.

9 Policy and Resource Implications

Resource Implications:

Financial: None

Legal:	None
Personnel:	None
Procurement:	None
Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.
Equality and Socio Economic Impacts:	
Does the proposal support the Council's Equality Outcomes 2017-22	Equalities issues are addressed in the Fund's Responsible Investment strategy, in the scheme rules which are the responsibility of Scottish Government and in the Fund's Communications Policy which has been the subject of an Equalities Impact Assessment.
What are the potential equality impacts as a result of this report?	No specific equalities impacts.
Please highlight if the policy/proposal will help address socio economic disadvantage.	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Sustainability Impacts:	
Environmental:	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Social, including Article 19 opportunities:	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Economic:	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Privacy and Data Protection impacts:	None.

10 Recommendations

The Committee is asked to **NOTE** the contents of this report.

Schedule 1

Strathclyde Pension Fund Investment Advisory Panel Overview

1. Role of Investment Advisory Panel

The role of the IAP, as described in the Fund's Statement of Investment Principles, is to provide support and advice to the Strathclyde Pension Fund Committee and to carry out certain functions on behalf of the Committee.

The functions of the IAP include:

- developing investment strategy
- monitoring investment performance
- assisting in the selection and appointment of investment managers
- setting and reviewing detailed investment mandate terms and guidelines
- implementation of the passive rebalancing strategy
- monitoring cash flows
- implementation of the private markets programmes.

2 Membership

The IAP comprises:

- 3 independent advisors;
- a representative from the Fund's investment and actuarial consultants;
- the Director (SPFO);
- the Chief Investment Officer (SPFO) and
- the Investment Manager (SPFO).

3 Meeting Arrangements

The IAP meets quarterly. Meetings usually comprise a strategy development session and a series of reviews of investment performance with the Fund's investment managers. IAP members also attend Committee meetings and occasional *ad ho*c IAP meetings.